

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

OF

**KCTS Television
Seattle, Washington**

AS OF DECEMBER 31, 2002

KCTS Television
Order No. G04-78
Exhibit A

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify that the attached Report of the Financial Examination of KCTS Television of Seattle, Washington shows the financial condition and related corporate matters as of December 31, 2002.

A handwritten signature in black ink, reading "Patrick H. McNaughton", written over a horizontal line.

Patrick H. McNaughton
Chief Examiner

A handwritten date in black ink, reading "November 10, 2004", written over a horizontal line.

Date

TABLE OF CONTENTS

SCOPE OF EXAMINATION	1
INSTRUCTIONS	1
COMMENTS AND RECOMMENDATIONS	3
COMPANY PROFILE	3
AFFILIATED COMPANIES	5
MANAGEMENT AND CONTROL	5
OWNERSHIP	5
BOARD OF DIRECTORS.....	5
OFFICERS.....	6
CONFLICT OF INTEREST	6
CORPORATE RECORDS	6
STATEMENT OF ACTUARIAL OPINION.....	6
ANNUITY ASSETS CUSTODIAL FUNCTION.....	7
ACCOUNTING RECORDS AND PROCEDURES	7
FINANCIAL STATEMENTS.....	8
ACKNOWLEDGMENT	10
AFFIDAVIT	11

SALUTATION

Seattle, Washington
November 9, 2004

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance 5000 Building
5000 Capital Blvd.
Tumwater, WA 98501

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of Chapter 48.38 RCW, Charitable Gift Annuity Business, an examination was made of the corporate affairs and financial records of

KCTS Television

of

Seattle, Washington

hereinafter referred to as "KCTS" at the location of its home office, 401 Mercer Street, Seattle, WA 98109.

This report of examination is respectfully submitted showing the condition of KCTS as of December 31, 2002.

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1998 through December 31, 2002. The examination was conducted in accordance with statutory requirements contained in the Revised Code of Washington (RCW) and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. We focused our review and testing on KCTS' management, operations, and reporting of the charitable gift annuity business as considered necessary to ascertain the financial condition of the organization and conformity with the related laws. These matters are discussed in this report. The examination was conducted at the Seattle office of KCTS by examiners from the state of Washington.

KCTS records along with various aspects of the organization's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the organization's Certified Public Accountant's report and work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the organization's filed 2002 Annual Report as part of the statutory examination. This review was performed to determine if the organization completed the Annual Report in accordance with the Annual Report Instructions published by the OIC and to verify that the organization's accounts and records were prepared and maintained in accordance with Title 48 of the RCW.

The following summarizes the exceptions noted while performing this review.

1. Annuities Payable/Reserves

The reported annuities payable, amounting to \$129,950, was understated by \$23,404 as of December 31, 2002. KCTS did not account for the actuary's calculated reserve amount plus ten percent (10%) of the calculated reserve, as required by RCW 48.38.020(1) and (3), in its accounting records. Consequently, the understated liability resulted in overstating temporarily restricted net assets by \$23,404. KCTS, therefore, did not comply with the accounting and reporting principles or practices prescribed or permitted by the Washington State Office of the Insurance Commissioner.

RCW 48.38.020 and states that:

- (1) "Upon granting to such insurer or institution under RCW 48.38.010 a certificate of exemption to conduct a charitable gift annuity business, the insurance commissioner shall require it to establish and maintain a separate reserve fund adequate to meet the future payments under its charitable gift annuity contracts."
- (3) "The amount of the separate reserve fund shall be:

- (a) For contracts issued prior to July 1, 1998, not less than an amount computed in accordance with the standard of valuation based on the 1971 individual annuity mortality table with six percent interest for single premium immediate annuity contracts and four percent interest for all other individual annuity contracts;
- (b) For contracts issued on or after July 1, 1998, in an amount not less than the aggregate reserve calculated according to the standards set forth in RCW 48.74.030 for other annuities with no cash settlement options;
- (c) Plus a surplus of ten percent of the combined amounts under (a) and (b) of this subsection."

KCTS is instructed to report the statutory reserve amount on its financial statements in compliance with RCW 48.38.020(1) and (3).

2. Assets of the separate reserve fund

The assets of the annuity reserve fund were not all physically segregated from the other assets of KCTS. \$94,067 or forty-nine percent (49%) of the total annuity assets of \$227,105 were commingled with the other funds in an investment pool. This practice did not comply with RCW 48.38.020(1) and (2).

RCW 48.38.020(1) states that, "Upon granting to such insurer or institution under RCW 48.38.010 a certificate of exemption to conduct a charitable gift annuity business, the insurance commissioner shall require it to establish and maintain a separate reserve fund adequate to meet the future payments under its charitable gift annuity contracts."

RCW 48.38.020(2) states that, "The assets of the separate reserve fund: (a) shall be held legally and physically segregated from the other assets of the certificate of exemption holder."

KCTS is instructed to develop a system for accounting, investing, and reporting of its charitable gift annuity business to ensure its compliance with RCW 48.38.020(1) and (2) (a).

3. Net Assets: Unrestricted, Temporarily Restricted and Permanently Restricted

The total of net assets shown in the December 31, 2002 Annual Report, amounting to \$11,769,308, was inaccurate. Reported amounts for unrestricted and temporarily restricted net assets did not agree with KCTS records. Adjustments were made and entered in the books after the report was submitted to OIC; therefore, those adjustments were not accounted for in the Annual Report. KCTS was not in compliance with the accounting and reporting principles or practices prescribed or permitted by the OIC.

As a result of the examination adjustments, the total of net assets reported in the Annual Report was increased to \$11,953,297 to agree with KCTS accounting records as of December 31, 2002. Also, the unrestricted net assets were decreased from \$1,011,394 to \$906,207, and temporarily restricted net assets were increased from \$7,237,227 to \$7,526,403.

RCW 48.38.010 states that, "The commissioner may grant a certificate of exemption to any insurer or educational, religious, charitable, or scientific institution conducting a charitable gift annuity business: (10) Which: (a) Files with the insurance commissioner on or before March 1 of each year a copy of its annual statement prepared pursuant to the laws of its state of domicile, as well as such other financial material as may be requested . . ."

KCTS is instructed, pursuant to Chapter 48.38 RCW, to develop a system for accounting and reporting of its charitable gift annuity business to ensure its compliance with the principles or practices prescribed or permitted by the OIC. The system should include procedures for review, by staff other than the report preparer, to assure the completeness and accuracy of the Annual Report.

COMMENTS AND RECOMMENDATIONS

Documentation of Closed Annuity Contracts

KCTS did not maintain adequate documentation, such as a death certificate, to sufficiently support the transfer to KCTS of the remaining annuity fund of a deceased annuitant during the year 2002.

It is recommended KCTS maintain adequate documentation of an annuitant's death. When a notification is received from a family member or executor of the estate, or by any other means, KCTS should contact the appropriate government agency to obtain a death certificate. All documents should be kept in the annuitant's file.

COMPANY PROFILE

History: KCTS is a nonprofit organization established in 1954 and incorporated in the state of Washington on September 16, 1983. KCTS provides public television programming, community outreach, and educational services to the region. It is a member of the Public Broadcasting Service and American Public Television. KCTS is the dominant public television broadcaster in the Seattle/Tacoma market, the 12th largest television market in the United States and ranks 4th among America's 347 public television stations with respect to the number of viewers. KCTS has additional coverage in British Columbia and elsewhere in Canada via cable and satellite.

Total Net Assets: As of December 31, 2002, the organization's adjusted total of net assets, as determined by this examination, were \$11,976,701. (See "INSTRUCTIONS" No. 1 and No. 3, and "FINANCIAL STATEMENTS") The total of net assets included unrestricted net assets of \$906,207. The minimum unrestricted net assets requirements are satisfied pursuant to RCW 48.38.010(6) as of December 31, 2002.

Territory and Plan of Operation: KCTS provides educational and cultural television programming through 24-hour program service distributed by transmitter and cable to viewers in the state of Washington and British Columbia, Canada. KCTS was granted a Certificate of

Exemption Number 23 to conduct a Charitable Gift Annuity business in the state of Washington by OIC on March 28, 1988. There were eighteen (18) in-force annuity contracts as of December 31, 2002. All of the 18 annuity contracts were issued to residents of the state of Washington, and included: eight (8) One Life (single) Annuities, Immediate Payments; one (1) Two Lives (joint) Annuity, Immediate Payment; four (4) One Life (single) Annuities, Deferred Payments; and five (5) Two Lives (joint) Annuities, Deferred Payments.

In the summer and fall of 2003, KCTS developed a three-year Business Plan which was intended to serve as both an operating guide and financing proposal for KCTS Television. Now in its 50th year of service to the community, KCTS is undertaking several initiatives to improve business practices throughout the station. In addition, KCTS is developing and implementing a strategic plan to strengthen its core revenue stream and broaden its core revenue base beyond membership, corporate underwriting, major gift and planned giving.

Growth of Company:

The growth of KCTS for the past five years is reflected in the following exhibits. All information was compiled from KCTS' filed financial statements as of fiscal years ending June 30. (Please note that this information is provided based on the company's fiscal year-end which is different than the examination as-of date.)

Schedule 1

Fiscal Year	Assets	Liabilities	Total Net Assets	Total Assets Allocated Into:		
				Unrestricted	Temporarily Restricted	Permanently Restricted
2002	\$30,868,189	\$18,735,961	\$12,132,228	(\$42,919)	\$8,657,776	\$3,517,371
2001	27,864,437	14,486,186	13,378,251	2,087,330	7,952,647	3,338,274
2000	22,402,361	9,748,762	12,653,599	3,795,569	5,770,448	3,087,582
1999	20,499,534	9,488,373	11,011,161	6,579,522	1,544,886	2,886,753
1998	21,071,856	10,747,441	10,324,415	5,398,535	2,190,100	2,735,780

Schedule 2

	<u>FY 2002</u>	<u>FY 2001</u>	<u>FY 2000</u>	<u>FY 1999</u>	<u>FY 1998</u>
Total Revenues	\$22,757,112	\$23,535,005	\$24,883,122	\$25,541,344	\$26,052,068
Total Expenses	24,003,135	22,810,353	23,240,684	24,854,598	27,112,449
Excess (deficit) of revenue over expenses	(1,246,023)	724,652	1,642,438	686,746	(1,060,381)
Net Assets at beginning of year	13,378,251	12,653,599	11,011,161	10,324,415	11,384,796
Net assets at end of year	<u>\$12,132,228</u>	<u>\$13,378,251</u>	<u>\$12,653,599</u>	<u>\$11,011,161</u>	<u>\$10,324,415</u>
Number of gift annuity contracts at end of year	18	17	13	14	13

AFFILIATED COMPANIES

KCTS operates a for-profit subsidiary, Channel 9 Corporation (the Corporation), which provides promotional and financial support for KCTS through the marketing of products related to public television programs. Another KCTS subsidiary, Intris, Inc. (Intris), a for-profit organization, provides promotional and financial support for KCTS through the development of DTV technology.

The accounts of the Corporation and Intris have been consolidated with the accounts of KCTS. Significant intercompany accounts and transactions have been eliminated in consolidation.

MANAGEMENT AND CONTROL

Ownership: According to the KCTS Television and Subsidiaries' Notes to Consolidated Financial Statement of June 30, 2002, KCTS is the owner and operator of the Federal Communications Commission's broadcast license. The license has been recorded at the nominal value of \$1 to represent ownership.

Board of Directors: Responsibility for governing the organization is vested in a Board of Directors comprised of eleven (11) persons. The Board meets at least quarterly during the year to discuss that business which is pertinent to KCTS. The Finance and Audit Committee of the Board of Directors reviews financial reports and any pertinent data and issues.

Members of the Board serving KCTS as of January 1, 2004 are as follows:

Doug Beighle Board Chair	Chairman, Puget Energy/Puget Sound Energy Served for nine (9) years
Nancy Evans Vice Chair	Former First Lady of Washington (1966-1977) Served for seven (7) years
Jean Gardner Secretary	Former First Lady of Washington (1985-1993) Served for nine (9) years
Jim Costello Treasurer	Partner, Price Waterhouse, LLP (Retired) Served for eight (8)
Mike Coie	CEO, Molbak's (Retired) Served for seven (7) years
Bob Flowers	President, NW Region, Washington Mutual Served for seven (7) years
Tomio Moriguchi	Chairman/CEO, Uwajimaya, Inc. Served for five (5) years

Don Nielsen	Former President, Seattle School Board Served for four (4) years
Terry Macaluso	Founder & President, NewThinker, LLC Served for one (1) year
Bob Redman KYVE	Partner/Shareholder, Gavin, Robinson, Kendrick, Redman & Pratt, Inc., PS (Retired), Served for two (2) years
Dorothy Byrne Director of KCTS Association	Corporate Secretary, Vancouver-Whistler 2010 Served for six (6) years

Officers: The officers of KCTS include a Chairman, Vice Chairman, President, Vice Presidents, a Secretary and a Treasurer as the Board may designate pursuant to Article IV of the Corporate Bylaws.

Conflict of Interest: KCTS' conflict of interest policy or code of conduct is a part of and is defined in the KCTS Television Employee Confidentiality Statement and Rights Agreement. The conflict of interest policy notes, "No Conflict: While I am employed by KCTS, I will not be employed by or perform any consulting or other services for any other person or entity that conflicts or competes with the business of KCTS or interferes with the proper and efficient performance of my duties at KCTS, unless KCTS consents in writing to such other employment or services." No exceptions were noted.

CORPORATE RECORDS

The Board of Directors meets at least quarterly during the year to discuss business which is pertinent to KCTS. Minutes of meetings of directors and finance committee approve and support organization transactions and events. No exceptions were noted.

Committees under the Board of Directors include: Benefits Committee, Executive Committee, Finance and Audit Committee, Nominating Committee, and Compensation and Personnel Committee.

STATEMENT OF ACTUARIAL OPINION

A consulting actuary with Milliman USA, Inc., determined the adequacy of the annuity reserves. In the Statement of Actuarial Opinion, the Actuary acknowledges that he is a member of the American Academy of Actuaries and meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion. His opinion indicates that KCTS' annuity contract reserves meet the requirements of RCW 48.38.020 of the Washington Insurance Code applicable to charitable gift annuities.

ANNUITY ASSETS CUSTODIAL FUNCTION

During the year 2002, some annuity funds have been held legally in Washington Federal Savings and physically segregated from the other funds of KCTS; some annuity funds have been held in The Bank of New York, an investment pool which contained other KCTS funds. The annuity funds have been designated in the general ledger as temporarily restricted funds under a separate fund number for annuities. The Board of Directors approves the investment policies, types of investments and any new investment accounts. The investment statements are reconciled monthly by either the Accounting Manager or the Controller. (See "INSTRUCTIONS" No. 2)

ACCOUNTING RECORDS AND PROCEDURES

KCTS classifies its activities by fund and according to donor-imposed restrictions. The three classifications are unrestricted, temporarily restricted, and permanently restricted. Unrestricted funds include general fund and National Endowment for the Arts fund. Temporarily restricted funds include capital fund, production fund, memorial fund, and annuity and life income fund. Permanently restricted funds include a program fund and endowment fund.

FINANCIAL STATEMENTS

The following examination financial statements show the financial conditions of KCTS as of December 31, 2002:

Balance Sheet

	Balance Per Annual Report	Adj. Notes	Examination Adjustments	Adjusted Balance
<u>ASSETS</u>				
Cash, cash equivalents and investments	\$7,199,497			\$7,199,497
Annuity investments	222,105			222,105
Land investments	776,600			776,600
Plant, equipment, and leasehold improvements, net	14,363,990			14,363,990
Other assets	6,536,052	Note 4	\$207,393	6,743,445
Interfund account	0			0
Total Assets	<u>\$29,098,244</u>		<u>\$207,393</u>	<u>\$29,305,637</u>
<u>LIABILITIES</u>				
Accounts payable and accrued expenses	\$2,140,419			\$2,140,419
Annuities payable	129,950	Note 1	23,404	153,354
Other liabilities	15,058,567			15,058,567
Total Liabilities	<u>\$17,328,936</u>		<u>\$23,404</u>	<u>\$17,352,340</u>
Unrestricted	\$1,011,394	Note 2	(105,187)	\$906,207
Temporarily restricted	7,237,227	Note 3	289,176	7,526,403
Permanently restricted	3,520,687		0	3,520,687
Total Net Assets	<u>\$11,769,308</u>		<u>\$183,989</u>	<u>\$11,953,297</u>
Total Liabilities and Net Assets	<u>\$29,098,244</u>		<u>\$207,393</u>	<u>\$29,305,637</u>

Adjustment Notes:

Note 1 – To adjust the reported annuities payable to agree with the calculated statutory annuity reserves. (See “INSTRUCTION” No. 1)

Note 2 – To recognize the corrections to unrestricted net assets made by KCTS subsequent to submission of the annual report to OIC. The adjustment brings the Annual Report into agreement with the organization’s financial statements. (See “INSTRUCTIONS” No. 3)

Note 3 – To recognize corrections to temporarily restricted net assets made by KCTS subsequent to submission of the annual report to OIC. The adjustment brings the Annual Report into agreement with the organization’s financial statements. (See “INSTRUCTIONS” No. 1 and No. 3)

Note 4 – To recognize the aggregate results of the examination adjustments, Note 2 and Note 3, to total assets. The adjustment brings the Annual Report into agreement with the organization's financial statements.

Statement of Financial Activity and Changes in Net Assets

	<u>Balance Per Annual Report</u>	<u>Adj. Notes</u>	<u>Examination Adjustments</u>	<u>Adjusted Balance</u>
Total revenues	\$25,245,424	Note 5	(\$390,401)	\$24,855,023
Total expenses	(26,604,024)	Note 5	(597,794)	(26,006,230)
Increase (decrease) in net assets	(\$1,358,600)	Note 5	\$207,393	(\$1,151,207)
Net assets at beginning of year:	13,127,908			13,127,908
Changes in net assets per examination		Note 6	(23,404)	(23,404)
Net assets at end of year	<u>\$11,769,308</u>		<u>\$183,989</u>	<u>\$11,953,297</u>

Adjustment Notes:

Note 5 – To recognize corrections to revenues, expenses, and changes to net assets made by KCTS subsequent to the Annual Report. The adjustment brings the Annual Report into agreement with the organization's financial statements. (See "INSTRUCTIONS" No. 3)

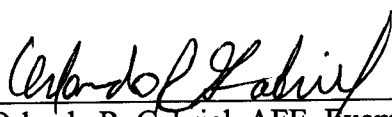
Note 6 – To recognize changes in net assets per examination (See Note 1 on page 8).

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of KCTS during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner, from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



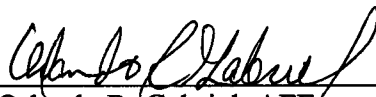
Orlando R. Gabriel, AFE, Examiner-in-Charge
State of Washington

AFFIDAVIT

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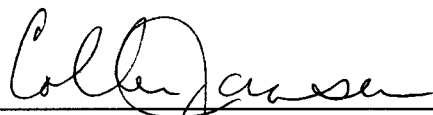
Orlando R. Gabriel, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of KCTS was performed in a manner consistent with the standards and procedures required or prescribed by the Office of the Insurance Commissioner of the State of Washington and the National Association of Insurance Commissioners (NAIC).



Orlando R. Gabriel, AFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me on this 9th day of November, 2004.



Notary Public in and for the
State of Washington,
Residing at Seattle.

